



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

U.I.L. – 507.05-00 No Third Party Contacts

Date: March 27, 2007

Contact Person:

Identification Number:

Release Number: **200725043**

Telephone Number:

Release Date: 6/22/07

Employer Identification Number:

Foundation =

Fund =

X =

Y =

Z =

A =

B =

X =

Dear

This is in response to Foundation's ruling request concerning a transfer of assets under sections 501, 507, 4940, 4941, 4942, 4944 and 4945 of the Internal Revenue Code.

Foundation is an organization exempt under section 501(c)(3) of the Code, and is a private foundation within the meaning of Section 509(a). Foundation's charitable activities consist solely of making grants to other tax-exempt charitable organizations described in section 501(c)(3). Foundation was created by X in 1994 and is the sole residuary beneficiary of the Estate of X.

Since formation Foundation's directors are X, Y and Z. After X died in 2001, there was a dispute between the two remaining directors regarding the charitable objectives and management of Foundation. Consequently, Y and Z entered into a Mediation Agreement (the Mediation Agreement), which was approved by a court and provided for the allocation of Foundation's total assets (including residue from the Estate of X) between Foundation under the control of Z, and another foundation bearing the name of X and under the control of Y. The allocation will be 2/3 to Foundation and 1/3 to the new foundation. The Mediation Agreement

also provided that the Foundation or the Estate shall pay Y's and Z's legal fees and pay or reimburse them their other fees in connection with the mediation. The court granted approval for the payment and finding the fees as fair, reasonable and not excessive under the circumstances.

Fund was created pursuant to the Mediation Agreement. Fund is exempt under section 501(c)(3) of the Code and a private foundation under section 509(a). The Fund's Certificate of Incorporation provides that upon Y's death, control of the Fund and its assets will pass to Foundation, provided it is an organization described under section 501(c)(3) of the Code.

Foundation transferred cash and securities valued at \$x in various dates as capital endowment fund to Fund (the Transfer). The grant agreement requires Fund to provide Foundation, on an annual basis, with written reports containing a description of its charitable activities and its receipts, disbursements and investments during the reporting period, together with assurances that its grants to other charitable organizations comply with applicable law.

Foundation has also paid its legal and other expenses under the court approved Mediation Agreement and in connection with the mediation and the Transfer.

Foundation has not notified the Service nor has a current intention to terminate its private foundation status.

Section 507(a) of the Code provides that, except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if--

- (1) such organization notifies the Secretary (at such time and in such manner as the Secretary may by regulations prescribe) of its intent to accomplish such termination, or
- (2) (A) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under chapter 42, and
(B) the Secretary notifies such organization that, by reason of subparagraph (A), such organization is liable for the tax imposed by subsection (c),

and either such organization pays the tax imposed by subsection (c) (or any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

Section 507(b)(2) of the Code provides that in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization.

Section 507(c) of the Code imposes a tax on each organization which terminates its private foundation status under section 507(a).

Section 1.507-1(b)(6) of the Income Tax Regulations (the "regulations") provides that if a private foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in section 507(b)(2) of the Code, such transferor foundation will not have terminated its private foundation status under section 507(a)(1).

Section 1.507-3(c)(1) of the regulations provides, in part, that a transfer of assets is described in section 507(b)(2) if it is made by a private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. The terms "other adjustment, organization, or reorganization" include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

Section 1.507-3(d) of the regulations provides that unless a private foundation voluntarily gives notice pursuant to section 507(a)(1), a transfer of assets described in section 507(b)(2) will not constitute a termination of the transferor's private foundation status under section 507(a)(1). Such transfer must, nevertheless, satisfy the requirements of any pertinent provisions of Chapter 42.

Section 1.507-4(b) of the regulations provides that private foundations which make transfers described in section 507(b)(2) are not subject to the tax imposed under section 507(c) with respect to such transfers unless the provisions of section 507(a) become applicable.

Section 1.507-3(a)(1) of the regulations provides that in the case of a significant disposition of assets to one or more private foundations within the meaning of paragraph (c) of this section, the transferee organization shall not be treated as a newly created organization. A transferee organization to which this paragraph applies shall be treated as possessing those attributes and characteristics of the transferor organization which are described in subparagraphs (2), (3), and (4) of this paragraph.

Section 1.507-3(a)(2)(i) of the regulations provides that a transferee organization to which this paragraph applies shall succeed to the aggregate tax benefit of the transferor organization in an amount determined as follows: Such amount shall be an amount equal to the amount of such aggregate tax benefit multiplied by a fraction the numerator of which is the fair market value of the assets (less encumbrances) transferred to such transferee and the denominator of which is the fair market value of the assets of the transferor (less encumbrances) immediately before the transfer. Fair market value shall be determined as of the time of transfer.

Section 1.507-3(a)(2)(ii) of the regulations, provides that notwithstanding (i) of this subparagraph, a transferee organization which is not effectively controlled (within the meaning of section 1.482-1(a)(3), directly or indirectly, by the same person or persons who effectively control the transferor organization shall not succeed to an aggregate tax benefit in excess of the fair market value of the assets transferred at the time of transfer.

Section 1.507-3(a)(4) of the regulations provides that if a private foundation incurs liability for one or more of the taxes imposed under Chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets described in section 507(b)(2) to one or more private foundations, in any case where transferee liability applies, each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the

transferor foundation does not satisfy such liability.

Section 4940(a) of the Code imposes on a private foundation with respect to the carrying on of its activities, a tax equal to 2% of its net investment income for the taxable year.

Section 4941(a) of the Code provides for the imposition of a tax on each act of self-dealing between a disqualified person and a private foundation.

Section 53.4946-1(a)(8) of the Foundation and Similar Excise Tax Regulations (also, the "regulations") provides that, for purposes of section 4941 only, the term "disqualified person" shall not include any organization which is described in section 501(c)(3) (other than an organization described in section 509(a)(4)).

Section 4944(a) of the Code provides generally for the imposition of a tax on a private foundation and a foundation manager if investments are made in such a manner as to jeopardize the carrying out of the foundation's exempt purposes.

Section 4945(a) of the Code imposes a tax on each taxable expenditure (as defined in section 4945(d)) of the private foundation.

Section 4945(d)(4) of the Code provides that the term "taxable expenditure" means an amount paid or incurred by a private foundation as a grant to an organization unless the private foundation exercises expenditure responsibility with respect to such grants in accordance with section 4945(h) of the Code.

Section 53.4945-5(c)(2) of the regulations provides that if a private foundation makes a grant described in section 4945(d)(4) to a private foundation which is exempt from taxation under section 501(a) for endowment, for the purchase of capital equipment, or for other capital purposes, the grantor foundation shall require reports from the grantee on the use of the principal and the income (if any) from the grant funds. The grantee shall make such reports annually for its taxable year in which the grant was made and the immediately succeeding 2 taxable years. Only if it is reasonably apparent to the grantor that, before the end of such second succeeding taxable year, neither the principal, the income from the grant funds, nor the equipment purchased with the grant funds has been used for any purpose which would result in liability for tax under section 4945(d), the grantor may then allow such reports to be discontinued.

In Rev. Rul. 73-613, 1973-2 C.B. 385, a dispute arose among the directors of a private foundation concerning its operation and management that caused the foundation to become inactive and prevented from carrying out its charitable purposes. A director, who is a foundation manager, filed suit against the other directors to require them to carry out the foundation's charitable purposes. The court approved a settlement and awarded legal fees to the counsel of the manager. The revenue ruling held that the payment by the foundation of the court awarded legal fees in settlement of the dispute enabled the foundation to renew its operation and carry out its charitable purposes and did not constitute self-dealing under section 4941 of the Code.

In Rev. Rul. 82-223, 1982-2 C.B. 301, Situation 2, a private foundation's payment of premiums on a liability insurance policy for its foundation manager for all liabilities, including settlement

amounts, arising under state management laws were reasonable administrative expenses incurred for charitable purposes and held not taxable expenditures under section 4945 of the Code.

The proposed transactions involve a private foundation's transfer of a significant part of its assets for capital endowment of an entity that qualified for exemption under section 501(c)(3) of the Code and not a notification of its termination as a private foundation. Accordingly, the proposed transfer is not a transfer described in section 507(a) of the Code which is subject to tax under section 507(c). Also, because Fund is exempt under section 501(c)(3) of the Code, the transfer of Foundation's assets to Fund will constitute a distribution for a charitable purpose and will not adversely affect the exempt status of Foundation, nor will it be treated as investment income, an act of self-dealing, a jeopardizing investment or taxable expenditure within the meaning of sections 4940, 4941, 4944 and 4945. In addition, Foundation's payment of legal and other expenses incurred in connection with the court-approved Mediation Agreement and settlement of the disputes between foundation managers of Foundation, will not be treated as acts of self-dealing under section 4941 or taxable expenditures under section 4945. See Rev. Ruls. 73-613 and 82-223.

Based on the foregoing, we rule, as requested, as follows:

1. The Transfer is a transfer described in section 507(b)(2) of the Code.
2. Because the Transfer is a transfer described in section 507(b)(2) of the Code.
 - a. The Transfer shall not affect Foundation's qualification as an organization described in section 501(c)(3) of the Code;
 - b. The Fund will not be treated as a newly created organization as provided in section 507(b)(2) of the Code and section 1.507-3(a)(1) of the regulations;
 - c. The Fund will succeed to the aggregate tax benefit of Foundation proportion to the assets transferred to it by Foundation as provided in section 1.507-3(a)(2) of the regulations;
 - d. If Foundation incurs liability for any taxes imposed by Chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, the Transfer, in any case where transferee liability applies, the Fund shall be treated as receiving the transferred assets subject to such liability to the extent that Foundation does not satisfy such liability as provided in section 1.507-3(a)(4) of the regulations;
 - e. Foundation will be required to meet its distribution requirements for the year or years in which the Transfer takes place in accordance with section 1.507-3(a)(5) of the regulations; and
 - f. The provisions of sections 1.507-3(a)(8)(ii)(a) through (g) of the regulations will apply to the Fund with respect to the assets transferred from Foundation.

3. The Transfer will not cause the termination of Foundation's status as a private foundation.
4. The Transfer will not cause the imposition of a termination tax under section 507(c) in the year or years in which the Transfer takes place.
5. The Transfer will not give rise to net investment income for either Foundation or Fund and will not result in the imposition of tax under section 4940(a) of the Code.
6. The Transfer will not constitute an act of self-dealing under section 4941 of the Code for Foundation or Fund and any of their disqualified persons.
7. The Transfer will not constitute a jeopardy investment under section 4944 of the Code with respect to Foundation or Fund.
8. The Transfer will not constitute a taxable expenditure under section 4945(d)(4) of the Code as Foundation will exercise expenditures responsibility under section 4945(h) with respect to its transfer to Fund.
9. The payment or reimbursement by Foundation pursuant to the mediation agreement of the legal fees and expenses (including the fees and expenses of mediation) of Y and Z incurred in the resolution of the dispute will not constitute acts of self-dealing with meaning of section 4941 of the Code.
10. The payment or reimbursement by Foundation pursuant to the mediation agreement of the legal fees and expenses (including the fees and expenses of mediation) of Y and Z incurred in the resolution of the dispute will be qualifying distributions within the meaning of section 4942 of the Code.
11. The payment or reimbursement by Foundation pursuant to the Mediation Agreement of the legal fees and expenses of Y and Z (including the fees and expenses of mediation) incurred in the resolution of their dispute will not constitute taxable expenditures within the meaning of section 4945 of the Code.
12. The legal, accounting and other expenses to be paid by Foundation in connection with the implementation of the Mediation Agreement (including effectuation of the Transfer) and this ruling request will be treated as qualifying distributions within the meaning of section 4942 of the Code and will not constitute as taxable expenditures under section 4945.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make

available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is conditioned on the understanding that there will be no material change in the facts upon which it is based. We express no opinion as to the tax consequences of the transactions under other provisions of the Code.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

This letter modifies and supersedes our ruling dated October 30, 2006.

Sincerely,

Debra J. Kaweck
Manager, Exempt Organizations
Technical Group 2

Enclosure
Notice 437